



Legal Services

180 South Clinton Avenue
Rochester, NY 14646-0700
716-546-7823 fax

Michael J. Shortley, III
Senior Attorney

Telephone: (716) 777-1028

February 29, 1996

BY OVERNIGHT MAIL

Mr. William F. Caton
Office of the Secretary
Federal Communications Commission
1919 M Street, N.W.
Washington, D.C. 20554

RECEIVED
MAR 1 1996
FCC MAIL ROOM

Re: CC Docket 94-1

DOCKET FILE COPY ORIGINAL

Dear Mr. Caton:

Enclosed for filing please find an original plus nine (9) copies of the Reply Comments of Frontier Corporation in the above-docketed proceeding.

To acknowledge receipt, please affix an appropriate notation to the copy of this letter provided herewith for that purpose and return same to the undersigned in the enclosed, self-addressed envelope.

Very truly yours,

Michael J. Shortley, III

cc: Tariff Division (2 paper copies)
Industry Analysis Division (1 diskette)
International Transcription Service

No. of Copies rec'd
List ABCDE

019

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554**

RECEIVED
MAR 1 1996
FCC MAIL ROOM

In the Matter of

**Price Cap Performance Review
for Local Exchange Carriers**

)
)
)
)

CC Docket No. 94-1

**REPLY COMMENTS OF
FRONTIER CORPORATION**

Frontier Corporation ("Frontier") submits this reply to the comments received in response to the Commission's Fourth Further Notice in this proceeding.¹ In this reply, Frontier will briefly address four issues: (1) the existence of a sharing option; (2) the elimination of the Consumer Productivity Dividend; (3) the treatment of the common line formula; and (4) the treatment of exogenous costs.² The suggestions contained herein are intended to provide guidance that will assist the Commission in reaching a balanced result that is fair to all affected parties.

¹ *Price Cap Performance Review for Local Exchange Carriers*, CC Dkt. 94-1, Fourth Further Notice of Proposed Rulemaking, FCC 95-406 (Sept. 27, 1995) ("Fourth Further Notice").

By order released January 16, 1996, the Common Carrier Bureau extended the time for filing replies to February 16, 1996. *Price Cap Performance Review for Local Exchange Carriers*, CC Dkt. 94-1, Order, DA 96-20 (CCB Jan. 16, 1996). By subsequent order released February 6, 1996, the Bureau again extended the time for filing replies, which are now due March 1, 1996. *Price Cap Performance Review for Local Exchange Carriers*, CC Dkt. 94-1, Order on Motion for Extension of Time, DA 96-138 (CCB Feb. 6, 1996).

² Although Frontier does not address the level of the X-Factor that the Commission should establish, it observes that the opposing proposals -- USTA at 2.8 percent (USTA at 2-3) and AT&T at 7.3 percent (AT&T at 27-29) -- appear extreme and based upon divergent assumptions and arguments that appear designed to drive the X-Factor either towards an unreasonably low or an unreasonably high outcome.

Argument

**I. SHARING SHOULD REMAIN AN
INTEGRAL COMPONENT OF
PRICE CAP REGULATION.**

Advocates at both ends of the debate agree that the Commission should provide at least one no-sharing option.³ Exchange carriers largely advocate the use of a total factor productivity methodology to establish the X-Factor that would, they argue, eliminate the need for any X-Factor options that contain a sharing requirement.⁴ This argument misses the point on two grounds.

First, the implicit assumption that the Commission may divine a mathematically precise X-Factor that leaves no possibility of error is simply incorrect. As the divergent studies cogently demonstrate, the inputs, assumptions and statistical and mathematical techniques chosen for the mode of analysis dramatically affect the ultimate conclusions of the studies.⁵ The most that the Commission may reasonably expect to achieve is an equitable outcome based upon the record evidence.⁶ Thus, because there will be room for honest disagreement regarding the appropriate level of the X-Factor, the Commission

³ *E.g.*, AT&T at 37-39; USTA at 38-41.

⁴ *E.g.*, USTA at 38-41.

⁵ *See supra* at 1 n.2.

⁶ This is not to say that the Commission may gerrymander the data to reach a preordained outcome. The result that the Commission ultimately reaches must be based upon a fair, reasonable and articulated weighing of the record evidence. *See Bell Atlantic v. FCC*, Brief for the Performance Review Petitioners and Intervenors in Support Thereof at 17-28 (D.C. Cir. final brief filed Dec. 6, 1995) ("Petitioners' Performance Review Brief").

should adopt a safety-valve -- in the form of at least one sharing option -- to address this inevitable concern. Moreover, continuation of this type of regime -- which the Commission currently has in place⁷ -- will permit the Commission to account for individual differences among price cap exchange carriers.

Second, a single X-Factor that does not contain a sharing requirement will fail to introduce a necessary "stretch factor" that should accompany a no-sharing option. This is particularly true if the X-Factor is set at a hypothetical industry average, as advocated by the exchange carrier industry.⁸ The opportunity to achieve unlimited earnings should carry with it a significant degree of risk. Otherwise the Commission would merely reward average performance with the possibility of extraordinary gain at the expense of interstate access customers. That result would contradict accepted economic theory and make little public policy sense.

II. THE COMMISSION SHOULD ELIMINATE THE CONSUMER PRODUCTIVITY DIVIDEND.

Of the two rationales that the Commission advanced for the adoption of the Consumer Productivity Dividend,⁹ the first has been achieved and the second has always been a *non sequitur*. The first justification -- to return to ratepayers the first benefits of

⁷ *Price Cap Performance Review for Local Exchange Carriers*, CC Dkt. 94-1, First Report and Order, FCC 95-132, ¶¶ 210-23 (April 7, 1995) ("First Report and Order").

⁸ See, e.g., USTA at 37.

⁹ In the First Report and Order, the Commission articulated *no* justification for retaining the Consumer Productivity Dividend.

price cap regulation¹⁰ -- has already been achieved through the use of the Consumer Productivity Dividend since the inception of price cap regulation. After almost five years of price cap regulation, the continued existence of the Consumer Productivity Dividend is no longer necessary to achieve this goal. Whatever gold-plating was induced by cost-of-service regulation has surely been eliminated by now¹¹ and, therefore, ratepayers have *already* received the first benefits of price cap regulation.

The second justification -- to force access rates down faster than they would otherwise decline -- is no justification at all, as has been previously explained.¹² While a properly-crafted price cap plan should include a significant element of risk as an inducement for the opportunity to earn higher returns, the Consumer Productivity Dividend is wholly unrelated to that policy objective. As currently constituted, the Consumer Productivity Dividend is simply the same add-on, regardless of which X-Factor a particular exchange carrier chooses. It adds nothing to the risk/return calculus that the multiple X-Factor regime already contains. While the Consumer Productivity Dividend may possibly have been justified at the inception of price cap regulation, whatever justification for its inclusion in the initial price cap plan has long since vanished.

¹⁰ See *Policy and Rules Concerning Rate for Dominant Carriers*, CC Dkt. 87-313, Second Report and Order, 5 FCC Rcd. 6786, 6799, ¶ 100 (1990).

¹¹ See Petitioners' Performance Review Brief at 30-31.

¹² *Id.* at 29-30.

**III. ADOPTION OF A TOTAL FACTOR
PRODUCTIVITY METHODOLOGY WILL
OBVIATE THE NEED FOR A
SEPARATE COMMON LINE FORMULA.**

If the Commission's key tentative conclusion -- that it should measure productivity on a total company basis¹³ -- is correct, as Frontier believes it is, then there will be no need for a separate common line formula. Use of a total factor productivity methodology -- one that, by definition, encompasses *all* exchange carrier services -- would already take into account common line services. Therefore, a separate common line formula would become unnecessary.¹⁴

AT&T's attempt¹⁵ to justify different intrastate and interstate productivity levels (which attempt therefore contains the implicit assumption that productivity may be discerned accurately for individual rate elements) fails. AT&T's assumption -- that because the Part 32 and 69 rules assign revenues and costs to particular rate elements or jurisdictions, those assignments necessarily reflect correct economic cost relationships¹⁶ -- is incorrect. The Commission has recognized that the contrary is likely true.¹⁷

¹³ First Report and Order, ¶ 159.

¹⁴ See, e.g., *Price Cap Performance Review for Local Exchange Carriers*, CC Dkt. 94-1, Comments of Frontier Corporation at 10-11 (Nov. 22, 1995) ("Frontier Comments").

¹⁵ AT&T at 13-18.

¹⁶ *Id.* at 14-15.

¹⁷ First Report and Order, ¶ 159; see also Fourth Further Notice, ¶ 63.

Moreover, the Commission's assumption¹⁸ -- that changes in the prices for common line services have little effect on demand for interstate, interexchange services -- is not historically accurate. Substantial reductions in access charges -- particularly carrier common line charges -- have fueled the explosive growth in demand for long distance services.

**IV. THE COMMISSION SHOULD REJECT
MCI'S SEPARATIONS-BASED
APPROACH TO EXOGENOUS COSTS.**

MCI continues to press its claim that the Commission should restrict exogenous cost recognition solely to changes in jurisdictional separations.¹⁹ MCI's suggestion continues to be misguided. The changes that the Commission has adopted to its exogenous cost rules²⁰ have already unduly restricted those categories of cost changes that qualify for exogenous cost treatment.²¹ MCI further fails to recognize that cost changes other than changes in the separations rules will have precisely the same effect as separations-based changes and yet would not, under its proposal, be afforded exogenous cost treatment.²² The proposal is arbitrary and ill-conceived.

¹⁸ *Id.*, ¶ 269.

¹⁹ MCI at 25-26.

²⁰ See First Report and Order, ¶¶ 293-94.

²¹ See, e.g., *Price Cap Performance Review for Local Exchange Carriers*, CC Dkt. 94-1, Comments of Rochester Telephone Corporation at 21-22 (May 6, 1994).

²² Frontier Comments at 11-12.

Conclusion

For the foregoing reasons, the Commission should adopt the proposals contained herein and in Frontier's comments.

Respectfully submitted,



Michael J. Shortley, III

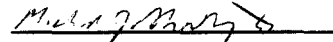
Attorney for Frontier Corporation

180 South Clinton Avenue
Rochester, New York 14646
(716) 777-1028

February 29, 1996

Certificate of Service

I hereby certify that, on this 29th day of February, 1996, the foregoing Reply Comments of Frontier Corporation were served by first-class mail, postage prepaid, upon the parties on the attached service list.


Michael J. Shortley, III